



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General

Office of Audit Services
Region IX
50 United Nations Plaza, Room 171
San Francisco, California 94102

October 18, 2004

Report Number: A-10-03-00014

Mr. Rick Miller
Chairman and Chief Executive Officer
Avamere Health Services, Inc.
25117 SW Parkway, Suite F
Wilsonville, Oregon 97070

Dear Mr. Miller:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General final report entitled "Audit of King City Rehab & Living Center's Medicaid Cost Report for Fiscal Year Ended June 30, 2000." A copy of this report will be forwarded to the HHS action official noted below for review and any action deemed necessary.

The action official will make final determination as to the actions taken on all matters reported. We request that you respond to the action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), Office of Inspector General reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-10-03-00014 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand", is written over a horizontal line.

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures – as stated

Direct Reply to HHS Action Official:

R. J. Ruff, Jr.
Regional Administrator, Region X
Centers for Medicare & Medicaid Services
2201 Sixth Avenue, MS/RX-40
Seattle, Washington 98121

cc: Gary Weeks
Director
Oregon Department of Human Services
500 Summer Street NE, E15
Salem, Oregon 97301-1097

Department of Health and Human Services
OFFICE OF
INSPECTOR GENERAL

AUDIT OF KING CITY
REHAB & LIVING CENTER'S
MEDICAID COST REPORT
FOR FISCAL YEAR ENDED
JUNE 30, 2000



OCTOBER 2004
A-10-03-00014

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

Office of Evaluation and Inspections

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs. The OEI also oversees State Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

Office of Investigations

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC at <http://oig.hhs.gov/>

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the awarding agency will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

King City Rehab & Living Center (King City) is a for-profit nursing facility in Tigard, Oregon, that provides services to resident patients who are eligible for Medicaid. During our audit period, Avamere Health Services, Inc. (Avamere) operated the facility under a management agreement. Avamere purchased King City in November 2000, after the end of our audit period.

In Oregon, the Medicaid program is administered by the Oregon Department of Human Services (State). The Oregon Administrative Rules (Admin Rules) describe allowable Medicaid costs under the Oregon Medicaid State plan and require that providers report these costs to the State on annual cost reports. The State uses the cost reports from all facilities in the State to establish statewide reimbursement rates.

OBJECTIVE

Our objective was to determine whether costs reported on King City's Medicaid cost report for the fiscal year ended June 30, 2000 (FY 2000) were allowable, allocable, and reasonable in accordance with Federal and State requirements.

SUMMARY OF FINDINGS

Of the \$4,609,810 reported on King City's Medicaid FY 2000 cost report, \$4,547,416 (over 98.6 percent) was allowable, allocable, and reasonable. However, the balance of \$62,394 was unallowable under Federal and State requirements. This amount consisted of (1) costs totaling \$20,742 that were not supported by adequate documentation, (2) costs totaling \$19,229 that were included on the cost report for employees' time spent at a different facility, (3) related party costs totaling \$15,420 that exceeded actual costs incurred, and (4) costs totaling \$7,003 that were misclassified on the cost report and should have not been claimed. These unallowable costs were claimed because Avamere did not have adequate policies, procedures, and controls to ensure compliance with Federal and State Medicaid program requirements.

RECOMMENDATIONS

We recommend that Avamere:

- submit a revised FY 2000 Medicaid cost report for King City that reduces costs reported by \$62,394
- improve existing policies, procedures, and controls to ensure that costs on the Medicaid cost report are (1) supported by adequate documentation; (2) allocable to King City; (3) reduced to actual costs incurred for related party transactions; and (4) allowable, classified in the proper accounts, and related to patient care

AVAMERE COMMENTS

In written comments on the draft report, Avamere accepted three of the findings and concurred with \$46,974 of the total costs of \$62,394 considered unallowable. Also, Avamere stated that it did not plan to file an amended cost report but instead would send a copy of the final adjustments to the State. Avamere stated that it would encourage the State to make any appropriate adjustments.

Avamere did not agree with the finding on related party costs. It acknowledged that there was common ownership between Avamere and the services supplier; however, Avamere stated that there was no common ownership between King City and the supplier.

Avamere's comments are included in their entirety as an appendix to this report.

OFFICE OF INSPECTOR GENERAL RESPONSE

Avamere should submit a revised cost report. However, if the State makes our recommended adjustments, that would be an acceptable alternative.

We believe that a related party relationship existed because of the control exercised by Avamere over King City under the management agreement and the common ownership between Avamere and the company that was supplying nursing services to King City.

INTRODUCTION

BACKGROUND

Medicaid Program

Title XIX of the Social Security Act created the Medicaid program, authorizing payments to States to provide medical assistance to people with limited income and resources. The Medicaid program is jointly financed by the Federal and State Governments and is administered by each State in accordance with a State plan approved by the Centers for Medicare & Medicaid Services. One part of the program provides medical assistance to eligible beneficiaries who are residents of Medicaid-certified nursing facilities.

Oregon State Plan

Under the Oregon State plan, each nursing facility was required to submit a cost report summarizing the costs incurred in providing services to eligible beneficiaries. The cost report also identified the total number of resident days for which those services were provided. The State used the cost reports from all facilities to establish statewide reimbursement rates paid for each resident day.

Oregon Administrative Rules

The State used chapter 411, division 70 of the Admin Rules to control payments for nursing facility services provided to Medicaid beneficiaries. In the program area, the Admin Rules defined the conditions for payment, requirements for residential care, and levels of service. In the financial area, the Admin Rules defined the requirements for filing annual cost reports and criteria for allowable costs.

King City's Organizational and Corporate Structure

King City is a for-profit nursing facility in Tigard, Oregon, that provides services to resident patients who are eligible for Medicaid. In April 1998, Health Resources, Inc., the owner of King City, entered into a management agreement with Avamere (previously called Genesis Health Care, Inc.). The agreement provided that Avamere would manage and operate King City and three other skilled nursing facilities in Oregon. Avamere purchased King City in November 2000, after the end of our audit period.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether costs reported on King City's FY 2000 Medicaid cost report were allowable, allocable, and reasonable in accordance with Federal and State requirements.

Scope

We reviewed the costs reported on King City's Medicaid cost report for the period July 1, 1999 through June 30, 2000. We performed the fieldwork from September 2003 through May 2004 at Avamere in Wilsonville, Oregon, and the King City facility in Tigard, Oregon.

Methodology

To accomplish our objective, we:

- reviewed applicable Federal and State regulations and guidelines
- reviewed King City's and Avamere's policies and procedures related to incurring and reporting Medicaid costs
- reconciled the cost report to King City's trial balance and general ledgers
- selected costs included on the cost report to determine if they were allowable, allocable, and reasonable

We conducted our audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Of the \$4,609,810 reported on King City's Medicaid FY 2000 cost report, \$4,547,416 (over 98.6 percent) was allowable, allocable, and reasonable. However, the balance of \$62,394 was unallowable under Federal and State requirements. This amount consisted of (1) costs totaling \$20,742 that were not supported by adequate documentation, (2) costs totaling \$19,229 that were included on the cost report for employees' time spent at a different facility, (3) related party costs totaling \$15,420 that exceeded actual costs incurred, and (4) costs totaling \$7,003 that were misclassified on the cost report and should have not been claimed. These unallowable costs were claimed because Avamere did not have adequate policies, procedures, and controls to ensure compliance with Federal and State Medicaid program requirements.

UNSUPPORTED COSTS

Admin Rule 411-070-0305 required that expenses be supported by adequate documentation. King City's cost report included \$20,742 of costs that were not supported by adequate documentation. This amount consisted of \$19,075 for pharmacy expenses and \$1,667 for bank loan fees. Avamere did not have adequate procedures for maintaining documentation.

EMPLOYEES WITH TIME SPENT AT A DIFFERENT FACILITY

Admin Rule 411-070-0359 provided that allowable costs were the necessary costs incurred for the customary and normal operation of a facility, to the extent that they were reasonable and related to resident care. King City's cost report included unallowable costs for salaries and benefits totaling

\$19,229 for two employees who split their time between King City and another Avamere facility. These costs consisted of \$17,229 for a dietitian and \$2,000 for a bookkeeper. Avamere did not have adequate procedures to ensure that salaries for employees working at more than one facility were properly allocated to the appropriate facilities.

RELATED PARTY CHARGES NOT REDUCED TO COST

Admin Rule 411-070-0335 provided that a related party relationship can be created because of common ownership of or control over the organizations. When this relationship exists, charges are allowable at cost, excluding profits and markups, for the related party. The charges also must not exceed costs that would be incurred by a prudent, cost-conscious buyer.

King City's cost report included unallowable charges for temporary nursing services from a company that had common ownership with Avamere. Avamere's cost report consultant proposed an adjustment of \$15,420 to the direct-care purchased services account on the cost report because of common ownership of the supplier and Avamere. However, Avamere decided not to make the adjustment because management did not consider King City to be a related party to the supplier. Avamere did not have controls to ensure that charges from related parties were limited to actual costs incurred, excluding profits and markups.

UNALLOWABLE EXPENSES THAT WERE MISCLASSIFIED

King City's cost report included unallowable expenses of \$7,003 in four areas:

- training and certification of nursing assistants
- auto mileage unrelated to patient care
- physician fees for patient-specific services
- donations

These unallowable costs were reported because they were misclassified.

Training and Certification of Nursing Assistants

Admin Rules 411-070-0359 and 411-070-0470 required that the costs of training and certifying nursing assistants be removed from the Medicaid cost report and submitted to the State in a separate report. King City's cost report included \$3,695 of unallowable costs for training and certification of nursing assistants. These costs were incorrectly recorded in the account Licenses, Dues & Subscriptions. Because these costs were misclassified, they were incorrectly left on the cost report.

Auto Mileage Unrelated to Patient Care

Admin Rule 411-070-0465 (10) (a) required that commuting expenses for the administrator of the facility be recorded as compensation. King City's cost report included \$2,980 of mileage allowance for the King City administrator's commute to the facility. The costs were misclassified in the account Administrative Travel. In May 2000, near the end of our audit period, Avamere initiated a

personnel action to include the allowance in the administrator's compensation but did not reclassify the costs.

Even if these costs had been recorded as compensation, they would have been unallowable because King City had already exceeded the maximum allowable compensation for an administrator. During a desk review, the State had already reduced the amount claimed for compensation on the FY 2000 cost report, in accordance with Admin Rule 411-70-0315, because the compensation had reached the allowable maximum.

Physician Fees for Patient-Specific Services

Admin Rule 411-70-0085 (1) provided that the nursing facility rate shall include all services. Further, Admin Rule 411-70-0359 (2) (e) specifically stated that services that are otherwise reimbursable through a third party are unallowable. King City's cost report included unallowable charges of \$245 in the physician consultant category for patient-specific services that were provided to one beneficiary on four different days. King City should not have included these charges on the cost report.

Donations

Admin Rule 411-70-0359 (2) (i) identified gifts and contributions as unallowable costs. King City's cost report included an unallowable charge of \$83 that was misclassified as Licenses, Dues & Subscriptions. The \$83 was part of a \$1,000 pledge that an owner of Avamere made to a health care foundation. The \$1,000 was billed to 12 facilities owned or managed by Avamere. Although there was a line item on the cost report for contributions, Admin Rule 411-70-0465 stated that the provider had the responsibility to make adjustments for unallowable items.

SUMMARY

Avamere did not have adequate policies, procedures, and controls to ensure compliance with Federal and State Medicaid program requirements. Specifically, Avamere did not ensure that costs claimed on the King City FY 2000 cost report were supported by adequate documentation; allocable to King City; reduced to actual costs incurred for related party transactions; and allowable, classified in the proper accounts, and related to patient care. As a result, King City's cost report included \$62,394 of unallowable costs.

RECOMMENDATIONS

We recommend that Avamere:

- submit a revised FY 2000 Medicaid cost report for King City that reduces costs reported by \$62,394
- improve existing policies, procedures, and controls to ensure that costs on the Medicaid cost report are (1) supported by adequate documentation; (2) allocable to King City; (3) reduced to actual costs incurred for related party transactions; and (4) allowable, classified in the proper accounts, and related to patient care

AVAMERE COMMENTS

In written comments on the draft report, Avamere accepted three of the findings and concurred with \$46,974 of the total costs of \$62,394 considered unallowable. Also, Avamere stated that it did not plan to file an amended cost report but instead would send a copy of the final adjustments to the State. Avamere stated that it would encourage the State to make any appropriate adjustments.

Avamere did not agree with the finding on related party costs totaling \$15,420. Avamere agreed that there was common ownership with the supplier of the nursing services but maintained that there was no common ownership between the supplier and King City. Avamere stated that the supplier was a separate legal entity and the related party requirements did not apply.

In its comments, Avamere stated that it would use the Office of Inspector General's findings while reviewing its current policies, procedures, and controls for account coding and cost allocations. Avamere indicated that, where needed, these systems would be enhanced.

Avamere's comments on our draft report are included in their entirety as an appendix to this report.

OFFICE OF INSPECTOR GENERAL RESPONSE

Avamere should submit a revised cost report. However, if the State makes our recommended adjustments, that would be an acceptable alternative.

We believe that a related party relationship existed because of the control exercised by Avamere over King City under the management agreement and the common ownership between Avamere and the company that was supplying nursing services to King City. Although the Admin Rules provided an exception, they required that if the provider took the position that an exception applied, the provider should not pay prices in excess of what would be paid by a prudent, cost-conscious buyer. Avamere's consultant calculated the \$15,420 adjustment to reduce the charges to that level.

APPENDIX


A V A M E R E Thursday, August 19, 2004

Office of Inspector General
Department of Health & Human Services
Region IX
50 United Nations Plaza, Room 171
San Francisco, CA 94102

RE: Audit of King City Rehab & Living Center's Medicaid Cost Report
 Report Number: A-10-3-00014
 FYE: June 30, 2000

Dear Lori Ahlstrand:

We are in receipt of your draft report # A-10-3-00014 dated July 30, 2004, Audit of King City Rehab & Living Center's Medicaid Cost Report.

We have attached hereto our formal response to each finding. In general, we do not necessarily agree with these findings however, the immateriality of the findings when compared to the enormous cost of this audit to both the Medicare Program and to our company, we challenge one finding and accept the remaining findings as written.

Avamere Health Services and related companies maintain a Corporate Compliance Program. We will utilize the OIG's findings while reviewing our current policies, procedures and controls for account coding and cost allocations. Where necessary these systems will be enhanced.

While we will not be filing an amended report due to the immateriality of these adjustments on any past, present or future rate, we will be sending a copy of the final adjustments to the Department and encourage them to make any adjustments to the cost report they see fit to make.

It has been a pleasure working with OIG auditors.

Sincerely,


Rick Miller, Chairman and CEO
Avamere Health Services, Inc

Avamere Health Services, Inc.

25117 SW Parkway, Suite F, Wilsonville, OR 97070 503 570-3405 FAX 503 570-3315

OUR MISSION IS TO ENHANCE THE LIFE OF EVERY PERSON WE SERVE

Finding – Unsupported Cost [\$20,742]

It is Avamere's policy to only pay expense when a sufficiently detailed invoice supports them. We firmly believe these invoices existed at the time these expenses were incurred. However, we cannot dispute the fact that they cannot now be found and accept this finding. We will be reviewing our system in an attempt to increase the accuracy of our filing systems.

Finding – Employees with Time Spent at Different Facility [\$19,229]

We do not dispute that the necessary allocation was overlooked.

Finding – Related Party Costs Not Reduced to Cost [\$15,420]

We do not agree that the owners of King City Rehab were related to the owners of Career Styles during the period of the cost report ending June 30, 2000. King City was owned by Health Resources Inc. and managed by Avamere Health Services. Avamere Health Services very obviously has common ownership with Career Styles; the owners of the Provider do not. Even if a related party relationship is identified, we believe the exception applies under Admin Rule 411-070-0335 (2).

The supplying organization is a separate legal entity, a significant amount of business was transacted with organizations other than the Provider, there is an open and competitive market and the prices charged to King City were not in excess of what a prudent and cost conscious buyer would pay. We ask the OIG re-consider this adjustment.

Finding – Unallowable Expense that were misclassified [\$7,003]

We concur with the OIG's findings and are reviewing our current policies, procedures and controls in an effort to prevent mis-coding of expenses.

Finding – Avamere did not have adequate policies, procedures and controls to ensure compliance.

While we should probably just agree with this finding, we feel that anytime an auditor places a nursing home under a 9 month long microscope, errors will be found. King City's error rate was 1.35%, we feel this is not too bad given that with all the systems of controls, checks and balances and good auditing practices, there are still humans processing payables, payroll and doing billing.

If the OIG is striving for 100% accuracy within the Medicare system, this may come but at what costs? We feel that the cost of perfection will significantly exceed the risk to the program.

We are reviewing our policies, procedures and controls within our entire system in an effort to increase the accuracy of financial statements.

ACKNOWLEDGMENTS

This report was prepared under the direction of Lori A. Ahlstrand, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

Thomas Lenahan, *Audit Manager*
Shelton Jensen, *Senior Auditor*
Cheryl Oka, *Auditor*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.